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Paul Norman
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Re: Comments of the Western Public Agencies Group on BPA's Power Function Review II Draft Close-out Letter

Dear Mr. Norman:

The Western Public Agencies Group (WPAG) provides the following comments in response to your draft close-out letter of April 4th, 2006, for Phase II of the Power Function Review (PFR II). The WPAG utilities appreciated this opportunity to obtain information on BPA's budgets, and the cost decisions that will drive BPA's rates in the future.

The effort to make more BPA financial information available to preference customers, through the PFR and other processes, will take on heightened importance as we move towards the expiration of the current BPA power sales contracts, and the negotiation and execution of new, long-term BPA power contracts. Better preference customer understanding of BPA's financial situation, and participation in the spending decisions that ultimately impact BPA rates, will be key to a smooth transition from the current power contracts to the new contracts in 2012. In particular, commencing the budget review process, including the capital program review, at the earliest possible date will be crucial to this transition. It would also be helpful to involve customers in a review of alternatives achieving BPA's fish and wildlife obligations. By employing "value engineering" techniques to these areas customers will gain confidence that their dollars are being spent efficiently. We encourage BPA to schedule these activities as soon as practicable.

<u>Comments</u>

The WPAG utilities support and endorse the comments submitted by the Public Power Council on specific topic areas that were discussed during the PFR II process. In addition, we would like emphasize the following comments:

1. **Amortization Periods.** As a general rule, BPA should match the amortization period to the life of the investment. In particular, the amortization period for conservation should be increased to 15 years, compared to the current 5 year amortization period. This would conform to the results of the Northwest Power and Conservation Council study. A similar approach should be taken for amortizing investments in fish and wildlife, most of which have service lives of at least 15 years. Taking such an approach in these areas will match up those who pay and those who benefit from these investments.

2. **Columbia Generating Station O&M.** The $35 million budgeted to replace the main condenser at CGS appears to be premature for the FY07-09 period, since the planning and design for this replacement have not yet been completed, and alternative approaches have not been examined.

3. **Corps and Bureau O&M.** The Corps' proposed $30 million Flood Control Review Feasibility Study should be eliminated as a BPA cost. This appears to be a non-power cost that should not be borne by electric ratepayers.

   The Northwest Regional Benchmarking Study has identified areas that will likely produce significant cost savings. Implementation of these actions should be given a high priority.

4. **EPIP Savings.** BPA confirmed its estimated EPIP savings of $8 million/year for FY2007-2009, and estimated EPIP savings of $11 to $12 million/year post FY2007. The implementation of the EPIP recommendations should be accelerated, and BPA should include the increased $12 million/year estimated savings in the Final Rate Proposal for the FY2007-09 period.

5. **DSI Benefits.** BPA decided in its June 30, 2005 Record of Decision on Service to the Direct Service Industries for the Years FY07-11 (DSI ROD) that it would offer the DSIs a "benefit" of $59 million/year during the FY2007-11 period. However, BPA conditioned that decision on the cost impacts to the Federal power system

from the litigation over the 2004 Biological Opinion. As stated in the DSI ROD, if the June 10, 2005 injunction were sustained, and if the summer spill regime were continued, BPA reserved the right to make offsetting reductions to the proposed DSI subsidy.

Both of the conditions cited in the DSI ROD have now come to pass. The 9th Circuit has affirmed the District Court's spill injunction, and the District Court has ordered river operations that are similar in cost to the June 10, 2005 injunction. However, in spite of these facts, the PFR II close-out letter suggests that a $59 million/year subsidy to the DSIs is still warranted. By way of explanation, the PFR II close-out letter suggests that more recent information regarding hydro operations and BPA's net secondary revenues for FY06 justify this conclusion. For preference customers, the logic of such an explanation is difficult to understand.

Regarding BPA's net secondary revenues for FY06, this provides no basis for implementing a $59 million annual subsidy for a three-year rate period, for two reasons. First, these secondary revenues should be used to reduce the rates of preference customers who have borne the brunt of BPA's financial difficulties and unfavorable hydro conditions for the last 5 years. Now that BPA has finally had a good water year, those financial benefits should be shared with BPA's preference customers, and not with one or two DSIs. And second, one good year of secondary revenues does not provide any assurance that good secondary revenues will occur in FY2007-09, when the funding for the DSI subsidy will be needed. One good water year does not guarantee revenues for a three-year subsidy, as recent experience has shown.

With regard to operations, it appears BPA is working at cross purposes. While declaring in the PFR II close-out letter that refined understanding of Federal system operations allows it to extend a $59 million/year subsidy to the DSIs, in its pending 2007 Wholesale Power Rate proceeding, BPA has proposed two separate cost recovery adjustment clauses (CRACs) to cover the potential cost impacts from the Biological Opinion litigation to hydro operations. And this potential exposure is so great that BPA has been unwilling to place any dollar limit on the amount of money it may recover under these two CRACs. If these two CRACs are warranted, clearly the cost exposure from this pending litigation argues for eliminating the proposed subsidy to the DSIs.

It is time for BPA to not only acknowledge that it is beyond its ability to guarantee DSI smelter operations at even a minimal level, but to act upon that fact by eliminating this proposed “benefit” payment to these aluminum smelters.

Conclusion

On behalf of the utilities of the Western Public Agencies Groups, I would again like to thank you and your staff for the effort that was put into PFR II, and express our commitment to working with BPA in the future on these important budgetary and financial matters.

Yours truly,

/S/ Terence L. Mundorf

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Attorney for the Western Public
Agencies Group